APPENDIX A

STATUTES AND REGULATIONS

Internal Revenue Code of 1954:

§ 61. Gross income defined

(a) General definition. — Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including (but not limited to) the following items:

(1) Compensation for services, including fees, commissions, and similar items;

(2) Gross income derived from business;

(3) Gains derived from dealings in property;

(4) Interest;

(5) Rents;

(6) Royalties;

(7) Dividends;

(8) Alimony and separate maintenance payments;

(9) Annuities;

(10) Income from life insurance and endowment contracts;

(11) Pensions;

(12) Income from discharge of indebtedness;

(13) Distributive share of partnership gross income;

(14) Income in respect of a decedent; and

(15) Income from an interest in an estate or trust.

• • • •

§ 453. Installment method

* * * *

(d) Gain or loss on disposition of installment obligations.—

(1) General rule.— If an installment obligation is satisfied at other than its face value or distributed, transmitted, sold, or otherwise disposed of, gain or loss shall result to the extent of the difference between the basis of the obligation and —

(A) the amount realized, in the case of satisfaction at other than face value or a sale or exchange, or

(B) the fair market value of the obligation at the time of distribution, transmission, or disposition, in the case of the distribution, transmission, or disposition otherwise than by sale or exchange.

Any gain or loss so resulting shall be considered as resulting from the sale or exchange of the property in respect of which the installment obligation was received.

* * * *

§ 662. Inclusion of amounts in gross income of beneficiaries of estates and trusts accumulating income or distributing corpus

* * * *

(c) Different taxable years. — If the taxable year of a beneficiary is different from that of the estate or trust, the amount to be included in the gross income of the beneficiary shall be based on the distributable net income of the estate or trust and the amounts properly paid, credited, or required to be distributed to the beneficiary during any taxable year or years of the estate or trust ending within or with his taxable year.

* * * *

§ 1014. Basis of property acquired from a decedent

(a) In general. — Except as otherwise provided in this section, the basis of property in the hands of a person acquiring the property from a decedent or to whom the property passed from a decedent shall, if not sold, exchanged, or otherwise disposed of before the decedent's death by such person, be the fair market value of the property at the date of the decedent's death, or, in the case of an election under either section 2032 or section 811(j) of the Internal Revenue Code of 1939 where the decedent died after October 21, 1942, its value at the applicable valuation date prescribed by those sections.

(b) Property acquired from the decedent. — For purposes of subsection (a), the following property shall be considered to have been acquired from or to have passed from the decedent:

* * * *

(6) In the case of decedents dying after December 31, 1947, property which represents the surviving spouse's one-half share of community property held by the decedent and the surviving spouse under the community property laws of any State, Territory, or possession of the United States or any foreign country, if at least one-half of the whole of the community interest in such property was includible in determining the value of the decedent's gross estate under chapter 11 of subtitle B (section 2001 and following, relating to estate tax) or section 811 of the Internal Revenue Code of 1939;

* * * *

§ 6501. Limitation on assessment and collection

(a) General rule. — Except as otherwise provided in this section, the amount of any tax imposed by this title shall

be assessed within 3 years after the return was filed (whether or not such return was filed on or after the date prescribed) or, if the tax is payable by stamp, at any time after such tax became due and before the expiration of 3 years after the date on which any part of such tax was paid, and no proceeding in court without assessment for the collection of such tax shall be begun after the expiration of such period.

* * * *

(e) Substantial omission of items. — Except as otherwise provided in subsection (c) —

(1) Income taxes. — In the case of any tax imposed by subtitle A —

(A) General rule. — If the taxpayer omits from gross income an amount properly includible therein which is in excess of 25 percent of the amount of gross income stated in the return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within 6 years after the return was filed. For purposes of this subparagraph —

(i) In the case of a trade or business, the term "gross income" means the total of the amounts received or accrued from the sale of goods or services (if such amounts are required to be shown on the return) prior to diminution by the cost of such sales or services; and

(ii) In determining the amount omitted from gross income, there shall not be taken into account any amount which is omitted from gross income stated in the return if such amount is disclosed in the return, or in a statement attached to the return, in a manner adequate to apprise the Secretary or his delegate of the nature and amount of such item.

* * * *

Internal Revenue Code of 1939:

§ 275. Period of limitation upon assessment and collection

* * * *

(c) Omission from gross income. If the taxpayer omits from gross income an amount properly includible therein which is in excess of 25 per centum of the amount of gross income stated in the return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within 5 years after the return was filed. 53 Stat. 86.

* * * *

United States Treasury Regulations:

§ 1.453-9. Gain or loss on disposition of installment obligations.

(a) In general. Subject to the exceptions contained in section 453(d)(4) and paragraph (c) of this section, the entire amount of gain or loss resulting from any disposition or satisfaction of installment obligations, computed in accordance with section 453(d), is recognized in the taxable year of such disposition or satisfaction and shall be considered as resulting from the sale or exchange of the property in respect of which the installment obligation was received by the taxpayer.

* * * *

APPENDIX B

OPINIONS AND JUDGMENTS BELOW

Court of Appeals Opinion

IN THE
UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 24729

ROBERT L. PHINNEY, District Director of Internal Revenue,

Appellant,

versus

RUTH KIEHL CHAMBERS, ET AL,

Appellees.

Appeal from the United States District Court for the Western District of Texas.

(February 13, 1968.)

Before TUTTLE and GEWIN, Circuit Judges and HUNTER, District Judge.

TUTTLE, Circuit Judge: This appeal from a summary judgment awarding to the individual appellee, Mrs. Chambers, and to the corporate appellee, Bank of the Southwest National Association, Houston, purporting to act as trustee for Mrs. Chambers, separate judgments for recovery of amounts paid by each of them separately on account of income attributed by the government to Mrs. Chambers, presents the question whether the trial court correctly applied the three year statute of limitations rather than the six year statute for the assessment of income taxes against the parties.

The facts are not in dispute. In 1954, Mrs. Chambers and her husband, Dunbar N. Chambers, owned as community property certain shares of the capital stock of High Point Realty Company. On July 1, 1954, they sold this stock at a profit to Mr. Frank W. Sharpe [*sic*] of Houston, Texas, receiving a cash down payment, with the balance of the consideration being evidenced by Mr. Sharpe's [*sic*] promissory note payable on or before September 1, 1957.

On a joint income tax return for 1954, the Chambers reported the sale and reported the income therefrom on the installment method in accordance with Section 453 of the Internal Revenue Code of 1954 and the Treasury Regulations thereunder.

On October 27, 1956, Mrs. Chambers' husband died and, under his will, the bank appellee became his executor. The bank took possession of Mrs. Chambers' half interest in the community property as well, since under the Texas laws all community debts may be satisfied out of all community property.

On the date of Mr. Chambers' death, the unpaid principal of the Sharpe [*sic*] note was $795,957.73, which was its fair market value. Mr. Chambers' half interest in that note of $397,978.87 was included in the gross estate for federal estate tax purposes. Its value was not disputed and in fact was accepted by the government. After some further payments were made, the then principal balance of the note, $751,472.13 was paid and collected in full on April 11, 1958.

For the fiscal year ended September 30, 1958, the bank, on March 13, 1959, pursuant to an extension of time for filling [*sic*], filed a U.S. fiduciary income tax return, Form 1041, as executor for the decedent's estate. The bank re-

ported on Schedule D of such return, $375,736.07. This item was reported on this return in the following manner: On line 7, under Schedule D and under the heading, "Long Term Capital Gains and Losses," there was an item, "Installment sale — schedule — $318,904.77." On the attached schedule, there were listed four categories under Schedule D:

"Sale of breeding herd, —"
"Sale of stock,—"
"Contract to sell Brahman herd"
"Installment sale."

Under "Installment sale" was the following explanation:

"Sale of High Point Realty stock	
Amount collected — Fiscal year ended 9-30-58	$378,736.07 [*sic*]
"Times percent of gross profit	84.07468%
"Gain to be reported:	$318,904.79."

On the same day that the foregoing report was made, for the income taxes due by Dunbar Chambers' estate, the bank filed a return in the following designation:

"Mrs. Dunbar N. Chambers — community one-half of estate of Dunbar N. Chambers, year ended 9-30-58."

On this return there is, of course, a corresponding Schedule D "Long Term Capital Gains and Losses — Assets Held More Than Six Months." On this return, line 7 appears to be blank, although there are some figures apparently on this schedule that are illegible. There appears to be no item to correspond at that place with the entry of "Installment Sale" shown on the husband's return. However, on a separately attached schedule, marked "Schedule D" there are several categories of Schedule D items which differ in significant respects from those attached to the correspond-

ing schedule to the return filed on behalf of the estate of Dunbar N. Chambers. The items listed in this return are:

"Sale of breeding herd —

"Sale of Stock —

"Contract to sell Brahman herd — ."

There is no item "Schedule D — Installment Sale" with the explanation such as is given on the other return itemizing the amount collected during the fiscal year ended 9-30-58, together with the percent of gross profit to be attributed thereto (84.87468%) and the gain to be reported of $318,504.79. Instead, *under the heading "Sale of Stock"* the last entry was as follows:

Descr [iption]	DATE Acquired	Sold	PRICE	BASIS	GAIN OR LOSS
High Point Realty Stock	10-27-56	1958 (date of death)	$375,736.06	$375,736.06	—0—

Mrs. Chambers filed a personal United States Income Tax Return, Form 1040, for 1958. She made no report or reference to the payment of $751,472.13, or her half, on the Sharpe [*sic*] installment note.

More than three years after the returns were filed by the bank and Mrs. Chambers respectively, the government determined that Mrs. Chambers' half interest in the community property note of Sharpe [*sic*] did not acquire a basis equal to its fair market value on the date of her husband's death. Consequently, its basis did not offset the amount received, and income resulted. Since the bank had purported to file a fiduciary return for Mrs. Chambers' half of the community property and since Mrs. Chambers did not report this amount in her individual return, the government

assessed a substantial tax deficiency against the bank on the return filed by it and separately against Mrs. Chambers for failing to include the item received on the installment note in her own individual return. The government also challenged several other items of deductions on the bank's return.

The parties agree that if the three year statute of limitation applies to these returns, then the tax was not assessable and the trial court correctly decided in favor of the two plaintiffs below, the appellees here, granting the tax refunds of the amounts which each of them respectively paid in response to the assessments.

The question whether the three year statute was applicable depends upon whether the "taxpayer" omitted from the gross income stated in the return "an amount, properly includible therein which is in excess of twenty-five percent of the gross income so stated." 26 U.S.C.A. § 6012 [*sic*].

The government contends that Mrs. Chambers should have reported the tax, and her failure to do so clearly brings the six year staute into play, for there was no disclosure on her return of any information that would give a lead to this item of income. The taxpayer, on the other hand, contends that the bank, as executor of the husband's estate, was legally required to file the return and that the inclusion of the amount of income received on behalf of Mrs. Chambers and reported as a "sale of stock" acquired the date of Mr. Chambers' death, with a basis equal to the sales price, prevented the six year statute from being applied. The contention is that there was no omission of any amount of gross income and even if there was, there was an adequate disclosure "in a manner adequate to apprise

the secretary [*sic*] or his delegate of the nature and amount of such item."

The District Director claims the right to proceed under the six year statute of limitations by reason of the provision of [the] Internal Revenue Code of 1954, § 6501(e)-(1)(A) which provides as follows:

> "(A) General Rule. — If the taxpayer omits from gross income an amount properly includible therein which is in excess of 25 percent of the amount of gross income stated in the return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within 6 years after the return was filed. For purposes of this subparagraph —"

The taxpayer, on the other hand, contends that since the figure given for the gross income of the taxpayer equaled the correct figure, if it had been stated with technical correctness as the payment of an installment note rather than the sale of stock, there was no omission from gross income of "an amount" at all. For this proposition, reliance is placed on *Colony, Inc.* v. *Commr.*, 357 U.S. 28. In addition, the taxpayer contends that subparagraph (ii) of Section 6501(e)(1)(A) prevents the application of the general rule stated above. Section (ii) provides as follows:

> "(ii) In determining the amount omitted from gross income, there shall not be taken into account any amount which is omitted from gross income stated in the return, if such amount is disclosed in the return, or in a statement attached to the return, in a manner adequate to apprise the Secretary or his delegate of the nature and amount of such item."

Rather than attempt to ascertain the true state of the Texas law, as it bears on the requirements of the federal taxing laws for the filing of a fiduciary return, in order to

decide whether in the circumstances here present it was the duty of Mrs. Chambers or of the executor of her husband's estate to file the income tax return for the fiscal year ending September 30, 1958, we will assume for the purpose of this opinion that it was the duty of the bank, since, in any event, the government is entitled to retain the amount of the taxes only once. We do this because it is simpler to resolve this purely federal problem in a manner that will be decisive of the litigation that [*sic*] to explore the effects here of the community property laws of Texas. For a discussion of some aspects of this problem see *Sneed* v. *Commissioner,* 220 F.2d 313 (5 Cir. 1955); *Henderson's Estate* v. *Commissioner,* 155 F.2d 310 (5 Cir. 1946); *Barbour* v. *Commissioner,* 89 F.2d 474 (5 Cir. 1937).

Much of the problem existing here arises from the fact that prior to the decision of the case of *Bath* v. *U.S.,* 211 F.Supp. 368, S.D. Tex., aff. 323 F.2d 980, 5 Cir, 1963, some community property state taxpayers were contending that in a situation such as here existed as to Mrs. Chambers, her half interest in the Sharpe [*sic*] promissory note would take a stepped-up basis at the time of her husband's death, under the provisions of § 1014(b)(6) of the Internal Revenue Code. Dealing with this proposition, the taxpayer's brief says:

> "Consistent with that belief, the taxpayers reported the transaction in question as resulting in no gain by reason of a step-up in basis, and the three year statute of limitations expired without any challenge having been made by the government to the taxpayers reporting.
>
> "After the three year period expired, the trial court decision was handed down in Bath v. U.S., 211 F.Supp. 368 (S.D. Tex., Nov. 30, 1962) aff. 323 F. 2d 980, 5 Cir., 1963.

> "The government then had [3 f.n. not copied] legal authority for the first time to deny the step up in basis, but the three year statute had run and the only way the government could get the horse back into the barn was to try to force the transaction under the six year statute."

The basic difficulty with the taxpayer's position here is that taxpayer simply didn't give the government a chance to make a "challenge" to the taxpayer's contention, because the taxpayer made no such contention on the return it filed. Although it fairly and simply reported on Mr. Dunbar Chambers' return that he had received a final payment on the installment note of which some 84% represented gain when his return was filed on March 13, 1959, it, for some reason that is not apparent, reported the income received as "trustee" for Mrs. Chambers in precisely the same amount under a *different* heading and under an *incorrect designation as of the sale of stock* acquired on 10-27-56 and sold in "1958." In point of fact, neither the trustee for Mrs. Chambers or Mrs. Chambers personally owned any High Point Realty Stock at any time after the sale to Mr. Sharpe [*sic*] in 1954. There was no sale of stock by the trustee either acting for Mrs. Chambers or as executor of the estate of her husband.

It appears that the same accounting firm, that on March 13, 1959 prepared the return filed for the bank as executor of Chambers' estate and correctly showed the collection of the Sharpe [*sic*] note under a heading separately listed on the schedule as "Schedule D — Installment Sale" and then showed the "amount collected for the fiscal year ended 9-30-58 and the computation of the percent of the amount received that represented profit then turned right around and on the return prepared for the bank to file for Mrs. Chambers' interests *on the same day* showed no such

separate item under Schedule D, but, instead, placed a similar amount of income as being received for a "sale of stock."

We consider it significant that at the very time that the government was contesting the "step-up in basis" theory of a community interest in an installment note such as Mrs. Chambers owned in the *Bath* case in another district court in Texas, this return was lying unchallenged in the files of the Internal Revenue Service.

It simply defies that the Internal Revenue Service, while contesting the right of Bath to claim a stepped-up basis in connection with a community property interest of less than $50,000 would have complacently permitted the similar claim for stepped-up basis in the Chambers estate to go unchallenged had the return filed on behalf of Mrs. Chambers disclosed what was really at issue, that is, as claimed by taxpayer, the amount received was in payment of an installment note, which, by virtue of the provisions of Section 1041(b)(6) [*sic*] of the Internal Revenue Code acquired a stepped-up basis upon the death of her husband. No better illustration could be devised to show the need for adequate disclosure as required under sub-section (ii).

The taxpayer claims that there is no need to inquire into the adequacy of the disclosure here because under the theory supported by the United States Supreme Court decision in *Colony, Inc.* v. *Commr., supra,* so long as the gross amount reported was not in error, there was no omission of "an amount" from the return at all. In light of the subsequent enactment of the 1954 Internal Revenue Code, including sub-paragraph (ii), we think the following language of the court's opinion in *Colony* should control here:

> "WE [*sic*] think that in enacting Section 275(c) [the 1939 Code provision, which is the predecessor of Section 6501(e)(1)] Congress manifested no broader purpose than to give the commissioner [*sic*] an additional 2 years [subsequently increased to 3 years] to investigate tax returns in cases where, because of a taxpayer's omission to report some taxable item, the commissioner [*sic*] is at a special disadvantage in detecting errors." 357 U.S. 32, 36.

We conclude that the enactment of subsection (ii) as part of section 6501(e)(1)(A) makes it apparent that the six year statute is intended to apply where there is either a complete omission of an *item* of *income* of the requisite amount or misstating of the nature of an item of income which places the "commissioner . . . at a special disadvantage in detecting errors."

This provision of the statute says that in determining whether "an amount" had been omitted from gross income, there shall not be taken into account any amount which is omitted if such amount is so shown on the return as to make it reasonably possible for the Secretary to detect errors. This, it seems to us, is to say that if an item of income is shown on the face of the return or an attached statement that is *not* shown in a manner sufficient to enable the secretary by reasonable inspection of the return to detect the errors then it *is* the omission of "an amount" properly includable in the return.

It seems here that there can be no substantial argument that the disclosure made by the bank's return was "adequate to apprise the Secretary or his delegate of the *nature* and amount of such item." (Emphasis added.)

It seems worth commenting on that here we do not have a novice individual taxpayer who had attempted to state an item of income, but has chosen a technically incorrect

handle to attach to it and is thus penalized for his lack of technical skill. We have, instead, a return filed for the taxpayer by the same accounting firm that had handled the taxpayer's return before Mr. Chambers' death and whose client has now alleged in its brief before us in this case that taxpayer was fully aware of the tax effects of the death of one of a community on the remaining member's ownership of a community interest in an installment note. Moreover, as already noted, the same accounting firm prepared for filing on the same day a return for the estate in which it adequately and clearly showed that income was received on the installment note as a payment as to which 84% represented taxable gain and then, on the return in question, incorrectly and improperly listed the income as if it were received for a sale of stock which had been acquired by the trustee and sold at the basis in the hands of the trustee, with, therefore, no tax owing.

While it would be simple to say that the proof that this item was not disclosed in a manner adequate to apprise the commissioner of its nature, is the fact that the commissioner did not discover the nature of this item at the very time that he was contesting the treatment of a similar amount in the Bath estate where the facts were properly disclosed, probably we cannot base our decision on that ground. We then turn to the conclusion that it would simply be a distortion of the meaning of ordinary words of common usage to hold that the reporting of this substantial income — the final payment on an installment sale as to which admittedly 84% was gain, and thus taxable during the calendar year — as a sale of stock that had been acquired by the fiduciary and sold at its basis in the hands of the fiduciary amounted to an adequate disclosure under the applicable statute. For one discussion of the meaning of paragraph (ii) see Richards, The Extended Statute of

Limitations on Assessment, 12 Tax Law Rev. 297, 316 and see *Walker* v. *Commr.*, 46 T.C. 630, 639.

We hold, therefore, that the trial court erred in applying the three year statute of limitations to the bank's return and the judgment in its favor must be REVERSED and the case REMANDED for further proceedings consistent with this opinion.

As to the judgment in favor of Mrs. Chambers, the government concedes that in the event of our determining that the bank was the proper fiduciary, a judgment in her favor is entitled to stand. The judgment in favor of Mrs. Chambers is, therefore, AFFIRMED.

REVERSED as to the Bank of the Southwest National Association, Houston, AFFIRMED as to Ruth Kiehl Chambers.

Court of Appeals Judgment

UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

October Term, 1967

No. 24729

D. C. Docket No. CA 66-11-A

ROBERT L. PHINNEY, District Director of Internal Revenue,
Appellant,

versus

RUTH KIEHL CHAMBERS, ET AL.,
Appellees.

Appeal from the United States District Court for the Western District of Texas.

Before TUTTLE and GEWIN, Circuit Judges and HUNTER, District Judge.

JUDGMENT

This cause came on to be heard on the transcript of the record from the United States District Court for the Western District of Texas, and was argued by counsel;

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the judgment of the said District Court in this cause be, and the same is hereby, affirmed in part and reversed in part, and that this cause be, and the same is hereby remanded to the said District Court for further proceedings consistent therewith;

It is further ordered and adjudged that the appellee, Bank of the Southwest National Association, Houston, be condemned to pay the costs of this cause in this Court for which execution may be issued out of the said District Court.

February 13, 1968

Issued as Mandate:

District Court Judgment

IN THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF TEXAS AUSTIN DIVISION

Filed Feb 2, 1967
MAXEY HART, Clerk
By Joe Steiner, Deputy

RUTH KIEHL CHAMBERS and BANK OF THE SOUTHWEST NATIONAL ASSOCIATION, HOUSTON, in its capacity as trustee of the Mrs. Dunbar N. Chambers - Community One-Half of Estate of Dunbar N. Chambers, Trust, Plaintiffs	)	CIVIL ACTION NO. 66-11-A
v.	)	
ROBERT L. PHINNEY, Defendant	)	

FINAL JUDGMENT

The above civil action, wherein Ruth Kiehl Chambers and Bank of the Southwest National Association, Houston, in its capacity as trustee of the Mrs. Dunbar N. Chambers - Community One-Half of Estate of Dunbar N. Chambers, Trust, are Plaintiffs, and Robert L. Phinney, District Director of Internal Revenue for the First Texas District, is Defendant, came on to be heard on January 23, 1967, on Plaintiffs' motion for summary judgment pursuant to Rule 56 of the Federal Rules of Civil Procedure.

It appearing to the Court from the pleadings (and exhits thereto), evidence, answers to interrogatories, admissions, affidavits, argument, briefs, and all other facts and matters considered and found by the Court that there is no genuine issue as to any material fact and that Plaintiffs

are entitled to a judgment as a matter of law for the reason that Defendant's assessments against and collections from Plaintiffs for their respective years ending in 1958 were erroneous and illegal because such assessments and collections were barred by the three-year period of limitations under section 6501(a) of the Internal Revenue Code of 1954 (26 U.S.C. § 6501(a)) and because the six-year period of limitations under section 6501(e) of the Internal Revenue Code of 1954 (26 U.S.C. § 6501(e)) did not apply in that there was no omission from gross income of an amount properly includible therein which was in excess of 25 percent of the amount of gross income stated in the return and which was not disclosed in a manner adequate to apprise Defendant of the nature and amount of such item; and for the reason that Defendant has under his own admission inconsistently taxed the same alleged item of income twice:

It is, therefore, ORDERED, ADJUDGED, and DECREED that Plaintiff Ruth Kiehl Chambers have and recover of and from Defendant judgment in the amount of $88,226.76 in principal tax, plus assessed interest in the amount of $31,776.14, or a total of $120,002.90; and that Plaintiff Bank of the Southwest National Association, Houston, in its capacity as trustee of the Mrs. Dunbar N. Chambers — Community One-Half of Estate of Dunbar N. Chambers, Trust, have and recover of and from Defendant judgment in the amount of $76,460.66 in principal tax, plus assessed penalty in the amount of $11,469.10, plus assessed interest in the amount of $28,685.32, or a total of $116,615.08.

It is further ORDERED, ADJUDGED, and DECREED that Plaintiffs have and recover of and from Defendant accrued interest on the respective amounts of such judgment from April 16, 1965, according to law.

It is further ORDERED, ADJUDGED, and DECREED that Plaintiffs have and recover of and from Defendant their costs according to law.

It is certified that Defendant acted with probable cause in the collection of the taxes herein involved.

All relief sought herein which is not expressly granted is denied.

Done this 2 day of February, 1967, at Austin, Texas.

/s/ Jack Roberts
United States District Judge

/s/ Charles W. Hall
Attorney for Plaintiffs

/s/ Leonard B. Tatar
Attorney for Defendant

APPROVED AS TO FORM:

APPENDIX C

CONFLICTING SUPREME COURT OPINION

THE COLONY, INC., *v.* COMMISSIONER OF INTERNAL REVENUE.

CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT.

No. 306. Argued April 3, 1958. — Decided June 9, 1958.

MR. JUSTICE HARLAN delivered the opinion of the Court.

The sole question in this case is whether assessments by the Commissioner of two asserted tax deficiencies were barred by the three-year statute of limitations provided in the Internal Revenue Code of 1939.

Under the 1939 Code the general statute of limitations governing the assessment of federal income tax deficiencies is fixed at three years from the date on which the taxpayer filed his return, § 275 (a), 53 Stat. 86, except in cases involving a fraudulent return or failure to file a return, where a tax may be assessed at any time. § 276 (a), 53 Stat. 87. A special five-year period of limitations is provided when a taxpayer, even though acting in good faith, "omits from gross income an amount properly includible therein which is in excess of 25 per centum of the amount of gross income stated in the return . . . ." § 275 (c), 53 Stat. 86. In either case the period of limitation may be extended by a written waiver executed by the taxpayer within the statutory or any extended period of limitation. § 276 (b), 53 Stat. 87.[1]

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[1] The pertinent provisions of the 1939 Code are:

"SEC. 275. PERIOD OF LIMITATION UPON ASSESSMENT AND COLLECTION.

"Except as provided in section 276 —

"(a) GENERAL RULE.—The amount of income taxes imposed by this chapter shall be assessed within three years after the re-

The Commissioner assessed deficiencies in the taxpayer's income taxes for each of the fiscal years ending October 31, 1946, and 1947, within the extended period provided in waivers which were executed by the taxpayer more than three but less than five years after the returns were filed. There was no claim that the taxpayer had inaccurately reported its gross receipts. Instead, the deficiencies were based upon the Commissioner's determination that the taxpayer had understated the gross profits on the sales of certain lots of land for residential purposes as a result of having overstated the "basis" of such lots by erroneously including in their cost certain unallowable items of development expense. There was no claim that the returns were fraudulent.

The Tax Court sustained the Commissioner. It held that substantial portions of the development costs were properly disallowed, and that these errors by the taxpayer

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turn was filed, and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period.

"(c) OMISSION FROM GROSS INCOME.—If the taxpayer omits from gross income an amount properly includible therein which is in excess of 25 per centum of the amount of gross income stated in the return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within 5 years after the return was filed.

"SEC. 276. SAME—EXCEPTIONS.

"(a) FALSE RETURN OR NO RETURN.—In the case of a false or fraudulent return with intent to evade tax or of a failure to file a return the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time.

"(b) WAIVER.—Where before the expiration of the time prescribed in section 275 for the assessment of the tax, both the Commissioner and the taxpayer have consented in writing to its assessment after such time, the tax may be assessed at any time prior to the expiration of the period agreed upon. The period so agreed upon may be extended by subsequent agreements in writing made before the expiration of the period previously agreed upon."

had resulted in the understatement of the taxpayer's total gross income by 77.2% and 30.7%, respectively, of the amounts reported for the taxable years 1946 and 1947. In addition, the Tax Court held that in these circumstances the five-year period of limitation provided for in § 275 (c) was applicable. It took the view that the statutory language, "omits from gross income an amount properly includible therein," embraced not merely the omission from a return of an item of income received by or accruing to a taxpayer, but also an understatement of gross income resulting from a taxpayer's miscalculation of profits through the erroneous inclusion of an excessive item of cost. 26 T. C. 30. On the taxpayer's appeal to the Court of Appeals the only question raised was whether the three-year or the five-year statute of limitations governed the assessment of these deficiencies. Adhering to its earlier decision in *Reis* v. *Commissioner*, 142 F. 2d 900, the Court of Appeals affirmed. 244 F. 2d 75. We granted certiorari because this decision conflicted with rulings in other Courts of Appeals on the same issue,[2] and

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[2] In conflict with this case are decisions in four different Courts of Appeals. *Uptegrove Lumber Co.* v. *Commissioner*, 204 F. 2d 570 (C. A. 3d Cir.); *Deakman-Wells Co.* v. *Commissioner*, 213 F. 2d 894 (C. A. 3d Cir.); *Slaff* v. *Commissioner*, 220 F. 2d 65 (C. A. 9th Cir.); *Davis* v. *Hightower*, 230 F. 2d 549 (C. A. 5th Cir.); *Goodenow* v. *Commissioner*, 238 F. 2d 20 (C. A. 8th Cir.). The Court of Claims has also held to the contrary of the present case. *Lazarus* v. *Commissioner*, 136 Ct. Cl. 283, 142 F. Supp. 897.

Three Courts of Appeals decisions antedating *Uptegrove Lumber Co.* v. *Commissioner, supra*, provided support for the Government's construction of § 275(c). *Foster's Estate* v. *Commissioner*, 131 F. 2d 405 (C. A. 5th Cir.); *Ketcham* v. *Commissioner*, 142 F. 2d 996 (C. A. 2d Cir.); *O'Bryan* v. *Commissioner*, 148 F. 2d 456 (C. A. 9th Cir.). But neither *Foster's Estate* nor *O'Bryan* can be regarded as the controlling authority within their respective circuits in view of the more recent decisions in *Davis* v. *Hightower, supra*, and *Slaff* v. *Commissioner, supra*. *Ketcham* is distinguishable on its facts.

The Sixth Circuit has consistently maintained its current position. The Tax Court has also regularly upheld the Commissioner. *E.g., American Liberty Oil Co.* v. *Commissioner*, 1 T. C. 386; *Estate of Giggs* v. *Commissioner*, 21 T. C. 443.

because the question as to the proper scope of § 275 (c), although resolved for the future by § 6501 (e)(1)(A) of the Internal Revenue Code of 1954, p. 37, *infra,* remains one of substantial importance in the administration of the income tax laws for earlier taxable years. 355 U.S. 811.

In determining the correct interpretation of § 275 (c) we start with the critical statutory language, "omits from gross income an amount properly includible therein." The Commissioner states that the draftsman's use of the word "amount" (instead of, for example, "item") suggests a concentration on the quantitative aspect of the error — that is, whether or not gross income was understated by as much as 25%. This view is somewhat reinforced if, in reading the above-quoted phrase, one touches lightly on the word "omits" and bears down hard on the words "gross income," for where a cost item is overstated, as in the case before us, gross income is affected to the same degree as when a gross-receipt item of the same amount is completely omitted from a tax return.

On the other hand, the taxpayer contends that the Commissioner's reading fails to take full account of the word "omits," which Congress selected when it could have chosen another verb such as "reduces" or "understates," either of which would have pointed significantly in the Commissioner's direction. The taxpayer also points out that normally "statutory words are presumed to be used in their ordinary and usual sense, and with the meaning commonly attributable to them." *DeGanay* v. *Lederer,* 250 U.S. 376, 381. "Omit" is defined in Webster's New International Dictionary (2d ed. 1939) as "To leave out or unmentioned; not to insert, include, or name," and the Court of Appeals for the Sixth Circuit has elsewhere similarly defined the word. *Ewald* v. *Commissioner,* 141 F. 2d 750, 753. Relying on this definition, the taxpayer says that the statute is limited

to situations in which specific receipts or accruals of income items are *left out* of the computation of gross income. For reasons stated below we agree with the taxpayer's position.

Although we are inclined to think that the statute on its face lends itself more plausibly to the taxpayer's interpretation, it cannot be said that the language is unambiguous. In these circumstances we turn to the legislative history of § 275(c). We find in that history persuasive evidence that Congress was addressing itself to the specific situation where a taxpayer actually omitted some income receipt or accrual in his computation of gross income, and not more generally to errors in that computation arising from other causes.

Section 275(c) first appeared in the Revenue Act of 1934. 48 Stat. 680. As introduced in the House the bill simply added the gross-income provision to § 276 of the Revenue Act of 1932, 47 Stat. 169, relating to fraudulent returns and cases where no return had been filed, and carried with it no period of limitations. The intended coverage of the proposed provision was stated in a Report of a House Ways and Means Subcommittee as follows:

> "Section 276 provides for the assessment of the tax without regard to the statute of limitations in case of a failure to file a return or in case of a false or fraudulent return with intent to evade tax.
>
> "Your subcommittee is of the opinion that the limitation period on assessment should also not apply to certain cases where the taxpayer has understated his gross income on his return by a large amount, even though fraud with intent to evade tax cannot be established. It is, therefore, recommended that the statute of limitations shall not apply where the taxpayer has failed to disclose in his return an amount of gross income in excess of 25 percent of the amount of the gross income stated in the return. The Government

should not be penalized when a taxpayer is so negligent as to leave out items of such magnitude from his return." Hearings before the House Committee on Ways and Means, 73d Cong., 2d Sess. 139.

This purpose of the proposal was related to the full Committee in the following colloquy between Congressman Cooper of Tennessee, speaking for the Subcommittee, and Mr. Roswell Magill, representing the Treasury:

"Mr. Cooper. What we really had in mind was just this kind of a situation: Assume that a taxpayer left out, say, a million dollars; he just forgot it. We felt that whenever we found that he did that we ought to get the money on it, the tax on it.

"Mr. Magill. I will not argue against you on that score.

"Mr. Cooper. In other words, if a man is so negligent and so forgetful, or whatever the reason is, that he overlooks an item amounting to as much as 25 percent of his gross income, that we simply ought to have the opportunity of getting the tax on that amount of money." House Hearings, *supra,* at 149.

The full Committee revealed the same attitude in its report:

"It is not believed that taxpayers who are so negligent as to leave out of their returns items of such magnitude should be accorded the privilege of pleading the bar of the statute." H. R. Rep. No. 704, 73d Cong., 2d Sess. 35.

The Senate Finance Committee approved of the intended coverage and language of the bill, except that it believed the statute of limitations should not be kept open indefinitely in the case of an honest but negligent taxpayer. Its report stated:

". . . Your committee is in general accord with the policy expressed in this section of the House bill. However, it is believed that in the case of a taxpayer who makes an honest mistake, it would be unfair to keep the statute open indefinitely. For instance, a case might arise where a taxpayer failed to report a dividend because he was erroneously advised by the officers of the corporation that it was paid out of capital or he might report as income for one year an item of income which properly belonged in another year. Accordingly, your committee has provided for a 5-year statute in such cases." S. Rep. No. 558, 73d Cong., 2d Sess. 43-44.

Except for embodying the five-year period of limitation, § 275(c), as passed, reflects no change in the original basic objective underlying its enactment.

As rebutting these persuasive indications that Congress merely had in mind failures to report particular income receipts and accruals, and did not intend the five-year limitation to apply whenever gross income was understated, the Commissioner stresses the occasional use of the phrase "understates gross income" in the legislative materials. The force of this contention is much diluted, however, when it is observed that wherever this general language is found its intended meaning is immediately illuminated by the use of such phrases as "failed to disclose" or "to leave out" items of income. See *Uptegrove Lumber Co.* v. *Commissioner*, 204 F. 2d 570, 572.

The Commissioner also suggests that in enacting § 275 (c) Congress was primarily concerned with providing for a longer period of limitations where returns contained relatively large errors adversely affecting the Treasury, and that effect can be given this purpose only by adopting the Government's broad construction of the statute. But this theory does not persuade us. For if the mere size of the error had been the principal concern of Congress, one

might have expected to find the statute cast in terms of errors in the total tax due or in total taxable net income. We have been unable to find any solid support for the Government's theory in the legislative history. Instead, as the excerpts set out above illustrate, this history shows to our satisfaction that the Congress intended an exception to the usual three-year statute of limitations only in the restricted type of situation already described.

We think that in enacting § 275 (c) Congress manifested no broader purpose than to give the Commissioner an additional two years to investigate tax returns in cases where, because of a taxpayer's omission to report some taxable item, the Commissioner is at a special disadvantage in detecting errors. In such instances the return on its face provides no clue to the existence of the omitted item. On the other hand, when, as here, the understatement of a tax arises from an error in reporting an item disclosed on the face of the return the Commissioner is at no such disadvantage. And this would seem to be so whether the error be one affecting "gross income" or one, such as overstated deductions, affecting other parts of the return. To accept the Commissioner's interpretation and to impose a five-year limitation when such errors affect "gross income," but a three-year limitation when they do not, not only would be to read § 275 (c) more broadly than is justified by the evident reason for its enactment, but also to create a patent incongruity in the tax law. See *Uptegrove Lumber Co.* v. *Commissioner, supra,* at 573.

Finally, our construction of § 275 (c) accords with the interpretations in the more recent decisions of four different Courts of Appeals. See note 2, *supra.* The force of the reasoning in these opinions was recognized by the Court of Appeals in the present case, which indicated that it might have agreed with those courts had the matter

been *res nova* in its circuit. 244 F. 2d, at 76. And without doing more than noting the speculative debate between the parties as to whether Congress manifested an intention to clarify or to change the 1939 Code, we observe that the conclusion we reach is in harmony with the unambiguous language of § 6501 (e)(1)(A) of the Internal Revenue Code of 1954.[3]

We hold that both tax assessments before us were barred by the statute of limitations.

Reversed.

THE CHIEF JUSTICE and MR. JUSTICE BLACK would follow the interpretation consistently given § 275(c) by the Tax Court for many years and affirm the judgment of the Court of Appeals in this case. See cases cited in note 2 of the Court's opinion.

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[3] "SEC. 6501. LIMITATIONS ON ASSESSMENT AND COLLECTION.

"(e) OMISSION FROM GROSS INCOME.—Except as otherwise provided in subsection (e)—

"(1) INCOME TAXES.—In the case of any tax imposed by subtitle A—

(A) GENERAL RULE. — If the taxpayer omits from gross income an amount properly includible therein which is in excess of 25 percent of the amount of gross income stated in the return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within 6 years after the return was filed. For purposes of this subparagraph—

"(i) In the case of a trade or business, the term "gross income" means the total of the amounts received or accrued from the sale of goods or services (if such amounts are required to be shown on the return) prior to diminution by the cost of such sales or services; and

"(ii) In determining the amount omitted from gross income, there shall not be taken into account any amount which is omitted from gross income stated in the return if such amount is disclosed in the return, or in a statement attached to the return, in a manner adequate to apprise the Secretary or his delegate of the nature and amount of such item." 68A Stat. 803, 804-805.